30 July, 2018

Mr David Thodey AO

Chair of the Independent Review of the Australian Public Service
Department of Prime Minister and Cabinet
PO Box 6500
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Dear Mr Thodey

**Submission to the Independent Review of the Australian Public Service: maintaining Australia’s regulatory assets**

Thank you for the opportunity to provide a submission to the Independent Review of the Australian Public Service.

In addition to serving the Government and Ministers of the day, an important role for the Australian Public Service lies in designing, maintaining and administering regulatory frameworks. Many of these have been built over considerable time and represent major investments of public resources and important (albeit intangible) public assets. Prime examples of high value regulatory infrastructure are the bodies of rules supporting the financial system, tax collection, competition, consumer protection and corporate law.

It stands to reason that, having invested heavily in establishing these important assets, the nation should insist that they are properly serviced and maintained, so as to stay in good running order. However, the day-to-day pressures on Governments and Departments often mean that all available resources are devoted to the immediate priorities, leaving essential maintenance investment undone, until a crisis triggers a major review. This approach of ‘running until failure’ is costly and wasteful.

A better approach would be to ensure that Departments and agencies invested appropriately to keep their stock of regulatory assets functioning well, at the same time as pursuing the current Minister’s policy agenda. In an environment of constrained resources this aspiration presents a challenge of leadership and will. To shore up the commitment of agency heads who may be tempted to focus purely on short term deliverables, Australia should introduce a statutory responsibility for regulatory stewardship similar to that applying in New Zealand. We attach a short paper on this theme for your consideration.

Yours sincerely

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## the importance of investment in regulation

Poorly functioning regulatory frameworks impose unnecessary costs that reduce productivity.[[1]](#footnote-2) These costs inevitably flow through to the community more widely, even when their initial impact is on a single business. Unnecessary costs reduce the national income and detract from the viability of domestic businesses, especially when they are exposed to overseas competition. Well-functioning regulatory frameworks provide markets with the catalyst to flourish and businesses with the confidence to invest.

In the past it has been convenient for advocates of regulatory proposals to downplay the burden of the additional regulation by either pointing to the overwhelming net benefit of imposing the particular regulation they sought, or dismissing the additional cost of further regulation as ‘second order’. However, in recent years, studies have shown that the aggregate cost of complying with regulation is significant.

In 2013 the stock of Commonwealth regulation was calculated to impose compliance costs of around $65 billion *per year* on the Australian economy. This calculation was based on estimates and survey data, and is not a true market calculation (in the sense that it includes costs of private citizens not typically included in GDP calculations), but it is nevertheless a staggering number. The Treasury Portfolio has by far the largest set of regulatory responsibilities, which are estimated to impose on the community a total annual compliance cost of around $47 billion through tax, financial system, corporations, competition and consumer laws and regulations. Of this figure, the taxation compliance burden is by far the largest component, comprising around $40 billion.

The Treasury is responsible for over 51,000 pieces of regulation[[2]](#footnote-3): an enormous body of regulatory material when one considers the primary income taxing act ⎯ the *Income Tax Assessment Act* 1997 ⎯ is counted in this figure as merely one regulation, and it alone comprises many thousands of pages. Most major sub-elements of that Act are tremendously complicated. There are, for example, over 800 pages of tax law solely devoted to the seemingly straightforward matter of taxing, or relieving from tax, gains arising from the sale of assets. Despite the red tape reductions achieved over the past few years, the community and business still see the accumulation of regulatory burden as a major pain point.

While of course *some* cost would be imposed by even the best designed taxation or other regulatory systems, the sheer size of the current compliance cost burden suggests we must be very far from best practice. If it were possible to reduce the present impost by even 10% — a reduction of around $6-7 billion per annum — the benefit to business and the community would be as large as those hoped for from many of the ambitious economic reforms pursued in recent decades.

It follows that a concerted effort to improve the way our regulatory frameworks are designed, administered and maintained is vitally important to our economy. Since the Treasury portfolio has responsibility for the lion’s share of regulatory compliance costs the Treasury should set the example, but every Department and agency must do its part.

## the Current state of regulatory frameworks

While Australia’s system of vetting new regulation compares favourably with international best practice[[3]](#footnote-4), the focus on new regulations (rather than existing ones) misses half the problem. Most of the attention in the history of regulatory reform in Australia has been on managing the *flow* of new regulations, but very little on ensuring the quality and efficacy of the *stock* of existing regulations. To use an old analogy, reducing the flow of pollutants coming into the lake from a tainted river without also taking action to clean the lake itself means the water stays dirty for a very long time.

To get a sense of the relative importance of the flow and the stock of regulatory burden: the absolute value of the reported flow (increases and decreases added together) of new regulation in the 18 months between 1 January 2016 and 30 June 2017 was $1.1 billion[[4]](#footnote-5). This compares with the annualised cost of the stock being around $65 billion.

A number of recent reviews[[5]](#footnote-6) have pointed to design features of regulatory frameworks that, in the light of experience, can be significantly improved. No rule-maker (including the Parliament) can predict how a set of rules will operate in all possible situations into the indefinite future. Just as the proverbial frog in the pot of water being slowly brought to boil is unaware of its worsening condition, the decline in effectiveness of regulations tends to go unnoticed until it is too late. The deterioration itself is no-one’s fault. Even the best designed regulations decay over time as the world changes, new business models emerge and new technologies are invented. Regulations conceived for static business models, earlier economic conditions or different societal and technological contexts, can quickly become outdated or inapplicable. New situations will inevitably arise that were not expected when the rules were written, and the rules may be interpreted, applied or responded to in unanticipated ways. Further, as recent developments in the field of behavioural economics are showing, people are unpredictable: often responding to regulatory interventions in counter-intuitive, unexpected ways.

Especially in challenging political times, as rule‑makers move quickly from one policy priority to the next, regulations can be seen as a ‘set and forget’ exercise. But inevitably, any regulatory framework, if left unmaintained, decays. Moreover, when regulatory change is formulated and implemented in haste, some proposed rules and regulations are barely more than hypotheses about how to change behaviour ⎯ an ‘educated guess’ as to how the future will play out. Without a conscious and explicit method of enabling established regulatory frameworks to autonomously adapt, or to be constantly reviewed and changed, any reform agenda is largely playing catch-up.

## How can we fix our regulatory frameworks?

There is general acceptance that regulation itself is not necessarily bad. Complex modern societies need regulations, for example, to protect consumers by creating statutory rights and remedies not provided by the general law and to lower transaction costs for firms by setting clear rules and a level playing field. Taxation is an essential element of modern society ⎯ indeed Oliver Wendell Holmes Jr described it as the price we pay for living in a civilised society. But, as Adam Smith recognised, ‘[every] tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.’[[6]](#footnote-7) The same principle holds for regulations governing the financial system, environment protection, competition, corporations and the list goes on. Unnecessary, ineffective or inefficient regulation is a drain on the nation’s means.

As it is sometimes hard to foresee the precise effects of regulation in advance, and regulatory challenges can change quickly, any model for regulatory design needs to allow for adaptation as regulatory effects become better known and new challenges emerge. Central to an agile and dynamic response is a carefully constructed hierarchy of regulations, assigning each rule-making function to the right level and devolving decision-making down the hierarchy where quicker responses to changing circumstances may be required.

In simple terms, as legislation made by the Parliament is typically hard to change, it should contain only those fundamental ideas and principles that can be expected to last. Subsidiary instruments, such as ministerial determinations, regulations and other binding legislative instruments can respond more quickly to technological and contextual changes and can therefore contain some operational detail. Non-legislative instruments, such as standards and guidance issued by regulators, complete the package. A good example of this form of regulatory design is the Consumer Data Right and Open Banking.

**EXAMPLE**

The Consumer Data Right gives customers greater access to and control over their data by requiring it to be shared at a customer’s express direction and in a machine readable form. It will be implemented economy-wide on a sector-by-sector basis, initially in the banking, energy, and telecommunications sectors. Open Banking ⎯ the Consumer Data Right for banking data ⎯ will be the first sector in which the right will be established. The Consumer Data Right has the potential to transform the way in which customers use and benefit from their information.[[7]](#footnote-8)

The Open Banking Review made the recommendation that Open Banking and the Consumer Data Right should be established with a set of rules general and flexible enough to facilitate innovation. This would be done by a coherent hierarchy of regulations, where the primary law sets out the enduring principles, for example, that a participant be ‘accredited’ to participate. The rules for that accreditation are then set by the regulator from time to time and promulgated as second tier regulations. The most particular and granular standards are determined by an appropriate body as non-binding, but strongly influential industry standards. These can evolve and be changed as quickly as necessary.

Next we need to establish a system for continually assessing and improving the existing stock of regulations. History shows that those proposing to change community behaviour via regulation tend to overestimate its benefits and underestimate the costs of their proposals. This is true both in the long-term and in relation to transitional costs. While effective stakeholder engagement in the design phase can go some way to addressing this, the biases and over-confidence of reforming zeal mean that some defects of design, that will require correction in the light of experience, are likely to remain. One-off reform efforts will not be sufficient. What is required is a standing capacity, in proportion to the regulatory footprint of Departments, for systematic evaluation and action.

This approach demands both the will and opportunity to implement the necessary changes. The challenge is to ensure that appropriate resources are devoted to a continuous improvement model for regulation, which can often be seen as mundane and low priority by Governments that have more pressing policy issues to deal with. One approach that seeks to overcome this drawback is ‘Regulatory Stewardship’.

## Regulatory stewardship

Regulatory stewardship (a term currently in use, if not coined, in New Zealand[[8]](#footnote-9)) describes a model where responsibility falls upon regulators, government departments and other agencies to undertake continuous evaluation of their stock of regulation.

New Zealand Government’s model of regulatory reform relies on a statutory mandate obliging departmental chief executives to exercise responsible oversight of regulatory systems. New Zealand’s Treasury describes this approach in these terms:

*‘[Regulatory stewardship is] a responsibility of government regulatory agencies. It involves them adopting a whole-of-system, lifecycle view of regulation, and taking a proactive, collaborative approach, to the monitoring and care of the regulatory system(s) within which they have policy or operational responsibilities.’*[[9]](#footnote-10)

New Zealand’s State Sector Act defines stewardship as the ‘active planning and management of medium- and long-term interests, along with associated advice’.[[10]](#footnote-11)

In this way, regulatory stewardship treats regulation as a public asset that requires maintenance to ensure that it remains fit for purpose, much like a physical asset such as a bridge or a road. The stewardship model recognises that maintenance of existing regulations is not a high profile, headline-grabbing activity for a government to pursue and thus it is easily crowded out by other policy priorities. However, it requires that some modest but consistent part of rule-makers’ attention goes to how we maintain our body of existing regulations. The alternative is that the system will eventually falter, and cost more to re-build and replace, just as building a new road is much more expensive than maintaining an existing one.

## Could regulatory stewardship be adopted in Australia?

The regulatory stewardship approach makes abundant sense, but it requires a step change in thinking about allocating time and resources to policy-making. It is a much harder and more sophisticated process than simply looking for regulations that are no longer necessary: the stock of existing regulation is so great that the purifying task is a major one that will take a great deal of time and continued application. But having such a responsibility placed on Departments could mean that, in time, our regulatory stock will become a living, dynamic and adaptable mechanism for ensuring the efficacy of the rules that are meant to function well in serving our communities.

In practice regulatory stewardship would require Departments and Agencies to establish clearly defined processes to evaluate whether regulatory interventions have in fact achieved their objectives, and further, whether those objectives are still relevant and the regulation still necessary and effective in this light. Achievements against plans could be periodically reviewed by the Productivity Commission in conjunction with the Australian National Audit Office (to get an appropriate balance of evaluation and audit).

A robust evaluation process would seek to identify distortions (such as technological bias); barriers to entering markets (either specific barriers, such as those facing Uber, or the barrier constituted by the fact that general complexity favours incumbency); unintended consequences; and whether the balance between compliance costs and benefits to the community continue to justify the regulation’s existence.

What are some principles that should be incorporated into a regulatory stewardship model for Australia?

* The model should set out the requirements for a coherent programme of evaluations of regulations: how they should be conducted, criteria for evaluation and targets for success. Evaluations should consider whether the benefits sought by the regulation have been achieved and whether they do in fact outweigh the costs of placing restrictions on the regulated population. Is there consistency and interoperability between that regulation and others that came before and after it?
* The approach should require a commitment to consultation with the population that is being regulated. Key questions would include: Do the key stakeholders that make up the regulated population engage with the regulations in the way that was envisaged, and what are their views on the regulation’s efficacy and desirability?
* Finally, the regulatory framework needs to cater for continuous improvement, with the role of specifying details that are likely to change most frequently being assigned to the appropriate level in the regulatory hierarchy, as described above for the Consumer Data Right in Open Banking.

## Conclusion

We live in digital age where the pace of change is unprecedented and increasing. If our regulatory frameworks are allowed to lag behind changes in society brought about by the technological revolution and its associated ‘disruptions’, the whole community pays the price.

A statutory mandate for Secretaries and agency Chief Executives to exercise stewardship of regulatory systems within their portfolio responsibilities would lay the foundations for a continuous improvement model for how we approach imposing and reforming regulatory in Australia. In this way we’re likely to see better outcomes overall for individuals, businesses and community organisations.

1. . Productivity Commission (2015), Business Set-up, Transfer and Closure – Productivity Commission Inquiry Report No. 75, 30 September 2015, Commonwealth of Australia, Canberra. [↑](#footnote-ref-2)
2. . The Treasury (2015), Stocktake of Regulation – Final Report, Commonwealth of Australia, Canberra. [↑](#footnote-ref-3)
3. . Australia regularly ranks highly in OECD reviews of regulatory discipline, based on the establishment of the *Office of Best Practice Regulation* and its *Regulation Impact Statement* process. However the gap between the system in theory and in practice is significant. [↑](#footnote-ref-4)
4. . Australian Government (2017), Annual Regulatory Reform Report 1 January 2016 – 30 June 2017, Commonwealth of Australia, Canberra. [↑](#footnote-ref-5)
5. . These reviews include the 2014 Financial System Inquiry, the 2015 Competition Policy Review and the Productivity Commission’ 2015 report on Business Set-up, Transfer and Closure. [↑](#footnote-ref-6)
6. . Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book V, Chapter II, Part II. [↑](#footnote-ref-7)
7. . The Treasury 2018, *Consumer Data Right*, Commonwealth of Australia, Canberra. [↑](#footnote-ref-8)
8. . New Zealand Government 2017, *Government Expectations for Good Regulatory Practice*, New Zealand Government, New Zealand. [↑](#footnote-ref-9)
9. . New Zealand Government 2017, *Government Expectations for Good Regulatory Practice*, New Zealand Government, New Zealand. [↑](#footnote-ref-10)
10. . The Treasury 2017, *Regulatory stewardship*, New Zealand Government, New Zealand, viewed 17 July 2018, <https://treasury.govt.nz/information-and-services/regulation/regulatory-stewardship>. [↑](#footnote-ref-11)